

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

77-4120

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

NO. 77-4120

SIDNEY R. SOLOMON AND BEATRICE SOLOMON,
Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

ON APPEAL FROM A DECISION OF
THE UNITED STATES TAX COURT

BRIEF FOR APPELLANTS

John S. Nolan
1700 Pennsylvania Avenue, N. W.
Washington, D. C. 20006
Attorney for Appellants

Of Counsel:

Robert L. Moore, II
Lee M. Goodwin
Miller & Chevalier
1700 Pennsylvania Avenue, N. W.
Washington, D. C. 20006

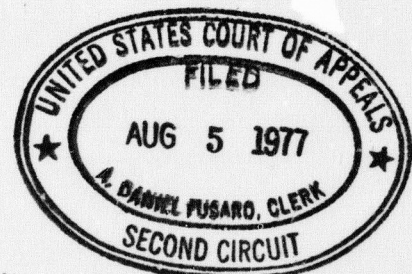


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ISSUES PRESENTED FOR REVIEW

The issue in this case is whether section 483 of the Internal Revenue Code of 1954 may be applied to treat part of the value of stock issued during the course of a tax-free corporate reorganization as imputed interest income. Section 483 provides that, in the case of a contract for the sale or exchange of property, part of any payment due more

than six months after the date of the sale or exchange will be treated as interest income to the creditor and interest expense to the debtor for tax purposes. The taxpayers (the appellants in this case) contend that section 483 is inapplicable in this case because there has been no deferred payment to which section 483 may be applied. The taxpayers further contend that the application of section 483 is inconsistent with the sections of the Internal Revenue Code which specify a comprehensive set of tax consequences for qualifying corporate reorganizations, and that the reorganization provisions must be given precedence under well-recognized rules of statutory construction. Accordingly, the taxpayers maintain that section 483 cannot be applied to the distribution of stock in this case, and that the Treasury regulation, 26 C.F.R. §1.483-1(b)(6), which attempts to apply section 483 to tax-free corporate reorganizations, is invalid.

STATEMENT OF THE CASE

Tax Court Proceedings

This is an appeal by Sidney R. Solomon and Beatrice Solomon from a decision of the United States Tax Court in favor of the Commissioner of Internal Revenue. The Court determined a deficiency in the taxpayers' 1971 income tax of \$42,939.64. The opinion by Judge William A. Goffe is

reported at 67 T.C. ___, No. 30 (1976), and was based on a stipulation of facts submitted by the parties.

Facts

Prior to 1968, the Detroit Bolt and Nut Company (Detroit) was owned and operated by the taxpayers and by Samuel and Doris Katkin. Sidney R. Solomon owned 1,391.5 shares, or 28.3 percent, of Detroit and Beatrice Solomon owned 913.5 shares, or 18.6 percent. The balance of the Detroit stock was owned by the Katkins and by the Quinn Manufacturing Company (Quinn), a corporation owned equally by the taxpayers and the Katkins.

In 1968, Whittaker Corporation (Whittaker) developed an interest in acquiring Detroit. On August 19, 1968, following extensive negotiations, the taxpayers entered into an Acquisition Agreement and Plan of Reorganization (the Agreement) with Whittaker. The taxpayers agreed to exchange their stock in Detroit and Quinn for Whittaker common and preferred stock. The parties have stipulated, and the Tax Court found, that the acquisition of the stock of Detroit and Quinn by Whittaker qualified as a tax-free reorganization under sections 354(a)(1) and 368(a)(1)(B) of the Internal Revenue Code. Accordingly, the taxpayers recognized no gain or loss upon the receipt of the Whittaker stock, and the basis and holding periods

of the Quinn and Detroit stock surrendered in the exchange carried over to the Whittaker stock acquired by the taxpayers.

Immediately after the execution of the Agreement, Sidney Solomon received 22,890 shares of Whittaker \$1.00 par value common stock and 6,037 shares of Whittaker \$5.00 par value preferred stock. Beatrice Solomon received 15,027 shares of Whittaker common stock and 3,963 shares of Whittaker preferred stock. All of the Whittaker stock was subject to substantial restrictions on its transferability.

Because the parties were unable to agree on the exact value of the Detroit and Whittaker stock, the taxpayers also received, as part of the exchange, a nonassignable right to receive additional shares of Whittaker stock. Articles 5.3 and 5.3.2 of the Agreement provided that additional Whittaker stock (up to a certain maximum) would be issued if the value of the Whittaker shares received at closing had not increased by 20 percent by the third anniversary of the closing date. Whittaker set up a reserved stock account, and the maximum number of shares that could be issued was set aside for possible future delivery. By the third anniversary of the closing date, the value of the Whittaker stock had decreased substantially. Accordingly, in 1971, all of the Whittaker stock in the reserved

stock account was issued to the taxpayers. It is this issuance of reserved stock to which the Commissioner of Internal Revenue (the appellee in this case) seeks to apply the provisions of section 483 of the Code.

Tax Court Opinion

The taxpayers' position in the Tax Court was that the receipt of stock in 1971 was not a deferred payment within the meaning of section 483. Judge Goffe, however, did not consider this point in deciding the case. Instead, he erroneously assumed that the point had been conceded by the parties, saying:

Petitioners do not contend that the shares transferred in 1971 are not 'payments.' Moreover, the regulations specifically include stock within the meaning of the term 'payments,' sec. 1.483-1(b)(1)(ii), Income Tax Regs., a term which may have different meanings when used in different Code sections.... (Slip Opinion, p. 10)

Because Judge Goffe had indicated that he had not considered the central issue in the case, the taxpayers filed a motion for reconsideration in which they again argued that there had been no deferred payment within the meaning of section 483. However, Judge Goffe again failed to address the taxpayers' argument. Instead, he merely amended his opinion by adding the underscored language to the paragraph quoted above:

Petitioners do not contend that the shares transferred in 1971 are not payments for their stock, but they, instead, contend that the shares transferred to them are not 'payments' within the meaning of section 483. Moreover, the regulations specifically include stock within the meaning of the term 'payments,' sec. 1.483-1(b)(1)(ii), Income Tax Regs., a term which may have different meanings when used in different Code sections....

It is clear that at no point in the proceedings was serious attention given to this issue.

The question whether there has been a deferred payment within the meaning of section 483 is central to this case. The taxpayers submit that they have received no deferred payment to which section 483 can possibly be applied. They further submit that any attempt to tax the receipt of stock in 1971 is flatly inconsistent with the reorganization provisions of the Internal Revenue Code and must therefore yield to those provisions.

Other Authorities

From the time of its enactment, the Treasury Department and the Internal Revenue Service have attempted to use section 483 to tax the delayed receipt of stock during the course of a qualifying corporate reorganization. In Regulation §1.483-1(b)(6), example 7, the Treasury Department indicated that it regarded section 483 as applicable to these so-called contingent stock reorganizations. The Service also ruled to this effect in Rev. Rul. 70-300, 1970-1

C.B. 125. It is the taxpayers' position that both the Treasury regulation and the Service's ruling are invalid because they attempt to extend section 483 to an area in which it cannot legitimately be applied.

In the instant case, and in the recent case of Alfred H. Catterall, 68 T.C. ___, No. 35 (1977), Judge Goffe of the Tax Court accepted the Commissioner's argument that section 483 is applicable to contingent stock reorganizations. A similar conclusion was reached by a closely divided Court of Claims in Jeffers v. United States, ___ Ct. Cl. ___, ___ F.2d ___, 77-1 USTC ¶9421; 40 AFTR 2nd 77-5026 (1977). In none of these cases, however, did the courts either recognize or deal with the basic issues raised by the attempt to apply section 483 to a qualifying corporate reorganization. Accordingly, they provide little useful guidance to this Court in resolving this case.

ARGUMENT

Section 483 applies only to transactions in which the payment of all or part of the purchase price has been deferred. When the acquisition of Detroit and Quinn by Whittaker is analyzed in light of the applicable statutes, cases and rulings, it is clear that the taxpayers' receipt of Whittaker stock in 1971 was not a deferred payment within the meaning of section 483.

In 1968, the taxpayers acquired an interest in Whittaker in exchange for their interest in Detroit and Quinn. For income tax purposes, the taxpayers received their entire equity interest in Whittaker in 1968, at the time of the initial exchange. Their receipt of Whittaker stock in 1971 is disregarded for tax purposes as a transaction with form but without substance. Accordingly, it cannot be a deferred payment for purposes of section 483. Moreover, looking behind the 1968 exchange, and considering the taxpayers' underlying investment in income producing assets, it is clear that there has been no material change in that investment by virtue of the transaction. In recognition of this, the Internal Revenue Code does not treat the exchange as a taxable event, and instead treats the parties as if the new stock continues to represent their original investment. For this reason, the taxpayers are considered for tax purposes to have held their Whittaker stock, including the interest represented by the stock certificates received in 1971, from the time they originally acquired their stock in Quinn and Detroit. The taxpayers cannot have received a deferred payment if they are considered for tax purposes to have held their Whittaker stock from before the time of the exchange. Thus, no matter how this transaction is approached, the tax laws preclude the application of section 483.

- I. THERE HAS BEEN NO DEFERRED PAYMENT WITH-
IN THE MEANING OF SECTION 483 BECAUSE THE
TAXPAYERS' INTEREST IN THEIR WHITTAKER
STOCK WAS RECEIVED AT THE TIME OF THE EX-
CHANGE AND WAS ACCORDINGLY NOT A DEFERRED
PAYMENT.
-

In 1968, the taxpayers exchanged their equity in-
terests in Detroit and Quinn for an equity interest in
Whittaker which was intended to be equal in value to the in-
terests surrendered. However, because the parties were un-
able to assign a precise dollar value to the two businesses,
only part of the taxpayers' equity interest in Whittaker
was represented by actual shares of Whittaker stock. The
balance of their equity interest was represented by a non-
assignable right to receive additional stock under certain
circumstances, the occurrence of which was beyond their con-
trol. That right to equity ownership in Whittaker served
the same function as the actual shares of Whittaker stock
in that it represented the taxpayers' ownership of a part
of Whittaker. Indeed, it is a fundamental and unquestioned
principle of tax law that the right of equitable ownership
in Whittaker represented by the right to this additional
Whittaker stock was, in substance, the Whittaker stock
which it represented. And, what is most important, it was
received at the time of the exchange.

In 1971, when the actual shares of Whittaker stock
were issued pursuant to the pre-exisitng right of equitable

ownership in Whittaker, only the formal indicia of the taxpayers' equity ownership was changed. Stock certificates replaced the taxpayers' right to receive that stock. This, however, was nothing more than a change in the form of the taxpayers' ownership interest, not in its substance. In substance, the taxpayers continued to own the same underlying equity interest that they had received at the time of the merger. When they received their Whittaker stock in 1971, the taxpayers received nothing that they did not already own. In short, there was no deferred payment. Since section 483 cannot apply unless there has been a deferred payment, it cannot apply to the taxpayers' receipt of Whittaker stock in 1971.

This precise issue was before the Court of Claims in the recent case of Jeffers v. United States, supra. In that case, the taxpayer's right to receive additional stock was represented by certificates of contingent interest. Although the four-judge majority in that case failed to consider this basic issue, the three dissenting judges did examine the issue and concluded that there had been no deferred payment to which section 483 could apply:

* * *The certificates of contingent interest were the same as stock and the plaintiffs owned the certificates and the stock which they represented from the day of the merger.

* * *

* * * Consequently, when the shares of stock were substituted for the certificates of contingent interest, there was no sale or exchange of property--only the substitution of one piece of paper for another, each being evidence of ownership of the same stock as of the date of the merger.

When this substitution occurred, there was no payment made. The transaction was merely the delivery to the Hayes stockholders of stock they had owned since the reorganization was completed.

Of course, there was no provision for interest, because the certificates were not indebtedness nor obligations for any kind of payment, and there was no occasion to provide for interest.

Therefore, it appears that the requirements have not been met which defendant says are necessary for the application of Section 483 and the cited Treasury Regulation. (Slip Opinion, pp. 22-23)

The stipulation and the findings in this case confirm that the right received by the taxpayers at the time of the original transaction with Whittaker was, in substance, a stock interest in Whittaker. The parties have stipulated, and the Tax Court found, that the entire transaction qualified as a tax-free reorganization under sections 354(a)(1) and 368(a)(1)(B) of the Code. Therefore, by virtue of section 354(a)(1), the taxpayers recognized no gain or loss on the exchange. It follows that the right which was received at the time of the merger can only be "stock" of

Whittaker, since only "stock or securities" may be received under section 354(a)(1) without the recognition of gain or loss (and "securities" are not involved in the present case). It also follows that the right cannot be an "evidence of indebtedness" within the meaning of section 483(c). Section 483 can only be applied in this case if the right received at the time of the exchange is an evidence of indebtedness. However, an evidence of indebtedness would be considered to be "other property" within the meaning of sections 354 and 356. The receipt of such other property would necessarily result in the recognition of gain, contrary to both the stipulation of the parties and the findings of the Tax Court.

Both judicial authority and the Commissioner's own rulings confirm that the over-all tax treatment of a qualifying reorganization is not altered by the fact that part of the equity interest received in the exchange is represented for a time by a right to stock rather than by actual shares of stock. In Carlberg v. United States, 281 F.2d 507 (8th Cir. 1960), the taxpayer received stock and certificates of contingent interest in a corporate reorganization. In concluding that the reorganization satisfied the "solely-for-voting-stock" requirement of sections 354 and 368, the Court held that the certificates of contingent interest were, in substance, the shares which they represented:

We emphasize also that, however one may choose to describe it, the Certificate of Contingent Interest represented only International common and nothing else. What the holder possessed was either stock or it was nothing. The number of shares to be forthcoming, it is true, was not determined with exactitude at the time of the merger but that fact does not change the character of the interest.

* * *

* * * It has often been said in tax arguments * * * that substance must prevail over form. If this observation has any independent legal force or merit in the determination of tax causes, it compels a conclusion that the substance of the Certificates equates only with stock of International. (281 F.2d. at 519-520)

The dissenters in Jeffers found the Carlberg case directly applicable to situations such as this:

The case of Carlberg v. United States, 281 F.2d 507 (8th Cir. 1960), directly supports the foregoing analysis that certificates of contingent interests are "stock" in a corporate reorganization and are not taxable as "other property" when the additional shares are exchanged for the certificates.

* * *

* * * The certificates of contingent interest in the instant case had the same effect (additional equity ownership) as of the date of the reorganization, and the later change in the indicia of such ownership (substitution of stock certificates for certificates of contingent interest) was not a deferred payment that calls for the application of Section 483 nor of the regulation issued

thereunder. Neither the statute nor the regulation is applicable unless there is a deferred payment, and such payment does not exist in the case before us. (Slip Opinion, pp. 23, 25)

The rules applicable to certificates of contingent interest also apply when there is no certificate to represent the right to additional stock. Thus, in James C. Hamrick, 43 T.C. 21 (1964), acq. 1966-1 C.B. 2, the Tax Court held that a right to additional shares was equivalent to the stock it represented for purposes of section 351(a) of the Code:

The respondent concedes that the stock issued in 1957 was received in exchange for the transfer of property. The contract right to receive additional stock was also a part of the consideration for the transfer. The right, as in Carlberg, can produce nothing other than stock to the petitioner. While the exact number of shares is not specified, what the petitioner can receive is nothing other than stock. Applying the rule of substance over form, we must conclude that the substance of the contract provides for only a stockholder's interest. It does not represent current gain, but additional equity ownership.* (43 T.C. at 33)

*The only detailed consideration of Judge Goffe's opinion in the instant case was given by the dissenters in the Jeffers case. It is significant that they found Judge Goffe's opinion completely irreconcilable with Hamrick and Carlberg:

Also, the judge's decision in the Solomon case appears to be contrary to the decision of his own court in Hamrick, supra, as well as contrary to the decision of the Eighth Circuit Court in Carlberg, supra. (Slip Opinion, p. 26)

The Service has acknowledged that these rules apply to mergers of the type involved here. Rev. Rul. 67-90, 1967-1 C.B. 79.

The rules applied in the Carlberg and Hamrick cases are applicable here as well. The taxpayers received their equity interest in Whittaker in 1968 at the time of the exchange. The subsequent issuance of Whittaker stock in 1971 pursuant to the terms of the merger agreement was a mere substitution of one indicia of ownership for another. The taxpayers' underlying ownership interest remained unchanged from the date of the initial exchange. Accordingly, there was no deferred payment to which section 483 can apply.

In his opinion, Judge Goffe relied on the statement in Reg. §1.483-1(b)(ii) that "for purposes of section 483, a payment may be made in cash, stock or securities, or other property..." to support his conclusion that section 483 applied to the receipt of Whittaker stock in this case. Judge Goffe, however, has misinterpreted that regulation. That regulation merely provides that a deferred payment may be made in any medium, including stock. It does not provide that any transfer of stock certificates is a deferred payment. Rather it presumes that the transaction in question constitutes a deferred payment. The regulation simply does not reach the threshold issue which

is crucial to this case: whether or not the issuance of Whittaker stock constitutes a deferred payment.

II. THE APPLICATION OF SECTION 483 IS IN DIRECT CONFLICT WITH THE REORGANIZATION PROVISIONS. ACCORDINGLY, THE SECTIONS SPECIFYING THE TAX CONSEQUENCES OF QUALIFYING REORGANIZATIONS MUST TAKE PRECEDENCE OVER SECTION 483 UNDER THE WELL-RECOGNIZED RULE OF STATUTORY CONSTRUCTION THAT SPECIFIC CODE PROVISIONS TAKE PRECEDENCE OVER GENERAL PROVISIONS.

As a qualifying corporate reorganization, the acquisition of Detroit and Quinn by Whittaker is governed by a group of long-standing and very specific Code sections. Section 354(a)(1) provides that the taxpayers recognize no gain or loss upon their receipt of Whittaker stock. Under the authority of Carlberg and the associated cases and rulings discussed above, this non-recognition treatment extends to the Whittaker stock received pursuant to the right to additional stock contained in the Agreement. It follows under section 358(a)(1) that the taxpayers' basis in their Detroit and Quinn stock carries over to the Whittaker stock received in the reorganization, including the stock received pursuant to this right to additional stock. It also follows, under section 1223(1), that the taxpayers are considered for tax purposes to have held their Whittaker stock, including the stock received pursuant

to the right to additional stock, from the time they first acquired the Detroit and Quinn stock surrendered in the exchange.

This pattern of tax treatment is provided in recognition of the business realities of corporate reorganizations involving the issuance of stock of the acquiring corporation for the assets or stock of the acquired company. No gain is recognized in such a reorganization, and the basis and holding period of the stock exchanged carry over because, in reality, there has not been a disposition of the essential property interests involved significant enough to justify the imposition of tax. Rather, there is a continuity of ownership interest accompanied by a readjustment in the formal nature of that interest. Indeed, no reorganization can qualify for the benefits of nonrecognition unless there is a continuity of ownership. The Government's own regulations confirm that, in a qualifying reorganization, there is no disposition of the underlying property interest:

(b) Purpose. Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures made in one of the

particular ways specified in the Code, as are required by business exigencies and which effect only a readjustment of continuing interest in property under modified corporate forms. (Reg. §1.368-1(b)) (emphasis added)

It is in recognition of this continuity of interest that section 1223(1) provides that the holding period of stock acquired in a qualifying reorganization includes the holding period of the stock surrendered in the exchange.

The Commissioner's attempt to apply section 483 to the instant transaction is in direct conflict with this specific pattern of tax treatment provided for a qualifying corporate reorganization. Section 483 presupposes a payment due at least six months after an exchange, while section 1223(1) clearly provides that stock received during the course of a qualifying reorganization is considered to have been held, for all purposes under the income tax laws, from before the date of the exchange. There can be no clearer conflict between two sections of the income tax laws. In the case of such a conflict, it is a fundamental rule of statutory construction that the more specific Code section must be given precedence over the more general section, regardless of priority of enactment. Bulova Watch Co. v. United States, 365 U.S. 753, 758 (1961). Under this rule, section 483 must yield in application to the more specific reorganization provisions.

The dissenters in Jeffers recognized that this fundamental principal prevents the application of section 483 to stock received during the course of a contingent stock reorganization:

In the present case, we should hold that Congress provided for tax-free corporate reorganizations by specific statutes. Section 483 of the Code is a general statute enacted to prevent a seller of capital assets from including interest as capital gain in a deferred payment in order to increase his income tax deductions. The statute was never intended to apply to a situation such as we have here. The general provision of Section 483 must give way to the specific statutes cited above providing for tax-free corporate reorganizations in line with the long and well-established rule set forth above. (Slip Opinion, p. 29)
(Emphasis in original)

Fox v. United States, 510 F.2d 1330 (3d Cir. 1975) confirms that the reach of section 483 is limited by this principle of statutory construction. The taxpayer in Fox argued that section 483 created an element of deductible interest in his otherwise nondeductible alimony payments to his wife. The Third Circuit, however, accepted the Government's argument that, despite its purportedly broad sweep, section 483 is governed by the fundamental canon of statutory construction that a general Code provision cannot change the tax consequences of a transaction governed by specific Code provisions which were enacted solely to deal with transactions of that sort. Accordingly, the Third

Circuit refused to allow the taxpayer's interest deduction despite the fact that section 483, by its literal terms, was applicable to his alimony payments. The principle established in Fox is equally applicable to this case. Section 483 cannot be applied to overturn the specific pattern of tax treatment provided by the reorganization sections of the Code.

The dissenters in Jeffers agreed that the holding in Fox governed the outcome of cases such as this:

The argument defendant makes in the instant case is contrary to the decision of the court in Fox v. United States, 510 F.2d 1330 (3d Cir. 1975), aff'g, 74-1 USTC ¶ 9358 (E.D. Pa. 1974) and contrary to the position the defendant took in that case.

* * *

In that case, the court held further that Section 483 could not be applied to allow interest in an alimony payment because it was governed for tax purposes by the more specific provisions of 26 U.S.C. §§71, 215 [Id at 1332]. This was exactly the position that defendant took in the Fox case which was sustained by the court. For instance, in the brief filed by defendant in the district court, the defendant stated:

It is a canon of statutory construction that when the legislature has enacted specific statutes in an area, they should take precedence over more general provisions unless there is a clear indication to the contrary. Monte Vista Lodge v. Guardian Life Ins. Co. of America, 384 F.2d 126, 129 (C.A. 9, 1967), cert. denied,

390 U.S. 550 (1968); Proutt's Estate v. Commissioner, 125 F.2d 591, 595 (C.A. 6, 1942), citing Helvering v. LeGirerse, 312 U.S. 531, 538 (1941).

Of course, that was a correct statement of the law and should be followed here. It should be pointed out that the defendant takes a directly opposite position in the instant case. The defendant should not be allowed to have it both ways. (Slip Opinion, pp. 28-29) (emphasis in original)

It is significant that the Commissioner has recently adopted the holding and the reasoning of the Fox case as part of the Service's published ruling policy. Rev. Rul. 76-146, 1976-1 C.B. 144 provides that no part of any alimony payment can be treated as interest under section 483 because the deductibility of such payments is governed exclusively by sections 71 and 215. In that ruling, the Service quoted extensively from the Fox case, and clearly indicated its approval of the Third Circuit's decision in that case.

The Fox case establishes that, as one of the broadest Code sections, section 483 must yield to other more specific provisions. It is equally well-established that the reorganization provisions are extremely specific and that in the case of a conflict, they take precedence over other more general sections. Movielab, Inc. v United States, 204 Ct. Cl. 6; 494 F.2d 693 (1974), judgment entered 503 F.2d 1406 (1974); Eastern Color Printing Co., 63 T.C. 27 (1974), acq. 1975-2 C.B. 1; Rev. Rul. 75-561, 1975-2

C.B. 129. In Movielab, a transaction qualified both as a complete liquidation of a subsidiary under section 332 and as a reorganization under section 368(a)(1)(F). Under section 381, which governs the carryback of the net operating loss deduction following liquidations and reorganizations, the treatment of liquidations is less favorable than that provided for reorganizations. The Court rejected the Government's claim that the transaction should be governed by the rules applicable to liquidations and held instead that since the reorganization provisions were the more specific provisions, they took precedence:

There is obviously good reason not to allow carryback treatment to all section 332 liquidations. Not every 332 liquidation could qualify under the stricter continuity of propriety interest and business enterprise tests which have evolved for "F" reorganization status. But if the reorganization does, as we so hold, qualify as an "F" reorganization, we can see no purpose, in either the technical or policy sense, in denying the "F" carryback benefits merely because of additional qualification under section 332. (494 F.2d at 701)

Similarly, if a contingent stock reorganization can satisfy the strict requirements of section 368, the reorganization provisions should take precedence notwithstanding the fact that another, broader Code provision might also be found to apply.

Judge Goffe resolved any possible inconsistency between the reorganization provisions and section 483 by referring to the list of exceptions contained in section 483(f), concluding that any situation not specifically excepted from section 483 by subsection (f) is governed by section 483. Like the rest of Judge Goffe's opinion, however, this conclusion presumes that the receipt of stock during the course of a corporate reorganization is a deferred payment within the meaning of section 483. This presumption has been shown to be in error. Judge Goffe's approach is also irreconcilable with both the decision of the Third Circuit in the Fox case and the Commissioner's own position in Rev. Rul. 76-146, supra. These authorities provide that no interest is to be imputed under section 483 to alimony payments whose tax treatment is governed by sections 71 and 215. Under Judge Goffe's reasoning, however, such a conclusion could not have been reached, since section 483(f) contains no exception for alimony payments.

Moreover, this conclusion is contrary to the consistent practice of Congress in drafting tax statutes. When Congress intends that a newly adopted section of the Code take precedence over other Code sections, including the reorganization provisions, it enacts a specific provision to that effect. For example, in section 1250, which was added by the same revenue bill that enacted

section 483, a special subsection was included which provided that: "This section shall apply notwithstanding any other provision of this subtitle". See also the similar language in section 1245(d), added just two years before section 483. This is a well-recognized drafting technique which is used when it is the intent of Congress that new provisions of the Internal Revenue Code override other applicable provisions of the Code, such as the nonrecognition provisions. In failing to provide specifically that section 483 governs "notwithstanding" the corporate reorganization provisions, Congress manifested an intent that the nonrecognition provisions applicable to corporate reorganizations were not to be overridden by section 483. The dissenters in Jeffers found this to be a significant weakness in the appellee's position:

* * * If Congress had intended that Section 483 should take precedence over the tax-free corporate reorganization statutes and impose a tax on corporate mergers, such as we have here, it would have so provided. In the absence of such a provision, it is clear that Congress did not intend for Section 483 to override the nonrecognition tax-free provisions. (Slip Opinion, p. 30)

The conflict between section 483 and the reorganization provisions cannot be resolved as easily as Judge Goffe suggests. In light of the fundamental rule of statutory construction applied in both the Fox and the Movielab cases, the only possible conclusion is that section 483 must yield to the more specific reorganization provisions.

III. THE PROPOSED APPLICATION OF SECTION 483 IS INCONSISTENT WITH THE EXTENSION OF THE BENEFITS OF NONRECOGNITION TO CONTINGENT STOCK REORGANIZATIONS.

The parties to a qualifying reorganization are frequently unable to agree on the value of their respective businesses. In recent years, it has become a common practice to resolve such valuation problems by entering into a contingent stock reorganization. In such a reorganization, a certain number of shares of stock are reserved for issuance at a later date when the uncertainties as to valuation have been resolved.

From the outset, the Commissioner has tried to eliminate the use of contingent stock issuance programs in qualified corporate reorganizations. Initially, the Commissioner attempted to prohibit such arrangements by completely disqualifying contingent stock reorganizations. However, the Court in Carlberg v. United States, supra, refused to accept the Commissioner's position. The Commissioner subsequently abandoned this approach in Rev. Rul. 66-112, 1966-1 C.B. 68 and Rev. Rul. 67-90, supra. Now the Commissioner has attempted to make the use of the contingent stock reorganizations economically impractical by subjecting them to taxation under section 483. In so doing, the Commissioner has ignored both the underlying rationale and the expressed language of the decisions in Carlberg and Hamrick, and has

attempted to accomplish by subterfuge what the courts have refused to allow him to accomplish directly. This attempt should not be allowed to succeed.

The decision in Carlberg clearly indicates that parties to a reorganization should be permitted to resolve differences as to valuation by the most accurate means possible without being required to sacrifice the benefits of the reorganization provisions:

* * * The Certificates can produce nothing other than stock and nothing other than a continuity of interest. The Certificates therefore fit the expressed basic purpose of the tax free provisions of the reorganization sections.

* * *

* * * Had they chosen to do so, the parties to the reorganization could have resolved the problem arbitrarily by distributing outright something less than the 49,997 Reserved Shares to the Maryland and Missouri stock holders in 1956 at the time of the merger and by letting International then take the benefit or the detriment of any ultimate difference. That the fairer and more exact method was chosen should not result in unfavorable tax consequences. (281 F.2d at 519)

The plain meaning of the Court's opinion is that the tax treatment of a qualifying reorganization is not altered by the fact that the continuing ownership interest is represented for a time by a right to receive additional stock rather than by the stock itself. If no contingent stock issuance had been provided in this case, the taxpayers

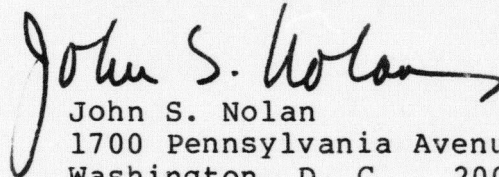
would have recognized no income of any sort as a result of the transaction. A different treatment should not be required simply because a contingent stock arrangement was sed in this case.

The Commissioner's attempted application of section 483 to this case ignores the expressed policy considerations underlying the judicial approval of contingent stock reorganizations. The use of a contingent stock issuance arrangement to resolve valuation problems in a manner expressly approved by the courts should not alter the tax-free nature of a qualifying reorganization. The Commissioner should not be allowed to eliminate the use of contingent stock arrangements indirectly, after the courts have clearly refused to permit him to accomplish it directly.

CONCLUSION

This Court should reverse the decision of the Tax Court and hold that the taxpayers recognized no income upon their receipt of Whittaker stock in 1971.

Respectfully submitted,



John S. Nolan
1700 Pennsylvania Avenue, N.W.
Washington, D. C. 20006
Attorney for Appellants

Of Counsel:

Robert L. Moore, II
Lee M. Goodwin
Miller & Chevalier
1700 Pennsylvania Avenue, N.W.
Washington, D. C. 20006
(202) 393-5660

ADDENDUM

Internal Revenue Code of 1954:

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) GENERAL RULE.--

(1) IN GENERAL.--No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * *

SEC. 358. BASIS TO DISTRIBUTEES.

(a) GENERAL RULE.--In the case of an exchange to which section 351, 354, 355, 356, 361, 371(b), or 374 applies--

(1) NONRECOGNITION PROPERTY.--The basis of the property permitted to be received under such section without the recognition of gain or loss shall be the same as that of the property exchanged--

* * *

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.--

(1) IN GENERAL.--For purposes of parts I and II and this part, the term "reorganization" means--

* * *

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

* * *

SEC. 483. INTEREST ON CERTAIN DEFERRED PAYMENTS.

(a) AMOUNT CONSTITUTING INTEREST.--For purposes of this title, in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which this section applies which are due under such contract.

(b) TOTAL UNSTATED INTEREST.--For purposes of this section, the term "total unstated interest" means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of--

(1) the sum of the payments to which this section applies which are due under the contract, over

(2) the sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of paragraph (2), the present value of a payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary. Such regulations shall provide for discounting on the basis of 6-month brackets and shall provide that the present value of any interest payment due not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment.

(c) PAYMENTS TO WHICH SECTION APPLIES.--

(1) IN GENERAL.--Except as provided in subsection (f), this section shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract--

(A) under which some or all of the payments are due more than one year after the date of such sale or exchange, and

(B) under which, using a rate provided by regulations prescribed by the Secretary for purposes of this subparagraph, there is total unstated interest.

Any rate prescribed for determining whether there is total unstated interest for purposes of subparagraph (B) shall be at least one percentage point lower than the rate prescribed for purposes of subsection (b)(2).

(2) TREATMENT OF EVIDENCE OF INDEBTEDNESS.--For purposes of this section, an evidence of indebtedness of the purchaser given in consideration for the sale or exchange of property shall not be considered a payment, and any payment due under such evidence of indebtedness shall be treated as due under the contract for the sale or exchange.

(d) PAYMENTS THAT ARE INDEFINITE AS TO TIME, LIABILITY, OR AMOUNT.--In the case of a contract for the sale or exchange of property under which the liability for, or the amount or due date of, any portion of a payment cannot be determined at the time of the sale or exchange, this section shall be separately applied to such portion as if it (and any amount of interest attributable to such portion) were the only payments due under the contract; and such determinations of liability, amount, and due date shall be made at the time payment of such portion is made.

(e) CHANGE IN TERMS OF CONTRACT.--If the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property is changed, the "total unstated interest" under the contract shall be recomputed and allocated (with adjustment for prior interest (including unstated interest) payments) under regulations prescribed by the Secretary.

(f) EXCEPTIONS AND LIMITATIONS.--

(1) SALES PRICE OF \$3,000 OR LESS.--This section shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed \$3,000.

(2) CARRYING CHARGES.--In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be made without regard to this section if any such amounts are treated under section 163(b) as if they included interest.

(3) TREATMENT OF SELLER.--In the case of the seller, the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to this section if all of the gain, if any, on such sale or exchange would be considered as ordinary income.

(4) SALES OR EXCHANGES OF PATENTS.--This section shall not apply to any payments made pursuant to a transfer described in section 1235(a) (relating to sale or exchange of patents).

(5) ANNUITIES. This section shall not apply to any amount the liability for which depends in whole or in part on the liability of one or more individuals and which constitutes an amount received as an annuity to which section 72 applies.

SEC. 1223. HOLDING PERIOD OF PROPERTY.

For purposes of this subtitle--

(1) In determining the period for which the taxpayer has held property received in an exchange, there shall be included the period for which he held the property exchanged if, under this chapter, the property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged, and, in the case of such exchanges after March 1, 1954, the property exchanged at the time of such exchange was a capital asset as defined in section 1221 or property described in section 1231. * * *

* * *

Treasury Regulations (1954 Code):

Treas. Reg. §1.483-1. Computation of interest on certain deferred payments.

* * *

(b) Payments to which section 483 applies--* * *

(6) Examples. The provisions of this paragraph may be illustrated by the following examples:

* * *

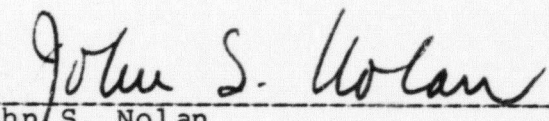
Example (7). M Corporation and N Corporation each owns one-half of the stock of O Corporation. On December 31, 1963, pursuant to a reorganization qualifying under section 368(a)(1)(B), M contracts to acquire the one-half interest held by N for an initial distribution on such date of 30,000 shares of M voting stock, and a nonassignable right to receive up to 10,000 additional

shares of M's voting stock during the next 3 years, provided the net profits of O Corporation exceed certain amounts specified in the contract. No interest is provided for in the contract. No additional shares are received in 1964 or in 1965, but in 1966 the annual earnings of O Corporation exceed the specified amount and on December 31, 1966, an additional 3,000 M voting shares are transferred to N. Section 483 applies to the transfer of the 3,000 M voting shares to N on December 31, 1966. See example (2) of paragraph (e)(3) of this section for an illustration of the computation of total unstated interest in this case.

* * *

CERTIFICATE OF SERVICE

I hereby certify that two copies of this Brief were served on F. Arnold Heller, attorney for the Appellee on August 4, 1977. Service was accomplished by personal delivery.



John S. Nolan